

AFTER THE CLOSING: AVOIDING PITFALLS DURING THE COMPLIANCE PERIOD

for the IPED- Learn the Basics: Housing Tax Credit 101

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IRS Form 8609: Line 10a

Form **8609** Low-Income Housing Credit Allocation and Certification
 (Rev. October 2014) Department of the Treasury Internal Revenue Service OMB No. 1545-0068
 Information about Form 8609 and its separate instructions is at www.irs.gov/form8609.

Part I Allocation of Credit
 Check if: Addition to Qualified Basis Amended Form

A Address of building (do not use P.O. box) (see instructions)

B Name and address of housing credit agency

C Name, address, and TIN of building owner receiving allocation

D Employer identification number of agency

E Building identification number (BIN)

TIN ▶

| | | | |
|---|---|-----------|-----|
| 1a Date of allocation ▶ | b Maximum housing credit dollar amount allowable | 1b | |
| 2 Maximum applicable credit percentage allowable (see instructions) | | 2 | % |
| 3a Maximum qualified basis | | 3a | |
| b If the eligible basis used in the computation of line 3a was increased, check the applicable box and enter the percentage to which the eligible basis was increased (see instructions) | | 3b | 1 % |
| <input type="checkbox"/> Building located in the Gulf Opportunity (GO) Zone, Rita GO Zone, or Wilma GO Zone <input type="checkbox"/> Section 42(d)(5)(B) high cost area provisions | | | |
| 4 Percentage of the aggregate basis financed by tax-exempt bonds, (if zero, enter -0-) | | 4 | % |
| 5 Date building placed in service | | | |
| 6 Check the boxes that describe the allocation for the building (check those that apply): a <input type="checkbox"/> Newly constructed and federally subsidized b <input type="checkbox"/> Newly constructed and not federally subsidized c <input type="checkbox"/> Existing building d <input type="checkbox"/> Sec. 42(e) rehabilitation expenditures federally subsidized e <input type="checkbox"/> Sec. 42(e) rehabilitation expenditures not federally subsidized f <input type="checkbox"/> Allocation subject to nonprofit set-aside under sec. 42(h)(5) | | | |

Signature of Authorized Housing Credit Agency Official—Completed by Housing Credit Agency Only

Under penalties of perjury, I declare that the allocation made is in compliance with the requirements of section 42 of the Internal Revenue Code, and that I have examined this form and to the best of my knowledge and belief, the information is true, correct, and complete.

Signature of authorized official Name (please type or print) Date

Part II First-Year Certification—Completed by Building Owners with respect to the First Year of the Credit Period

7 Eligible basis of building (see instructions)

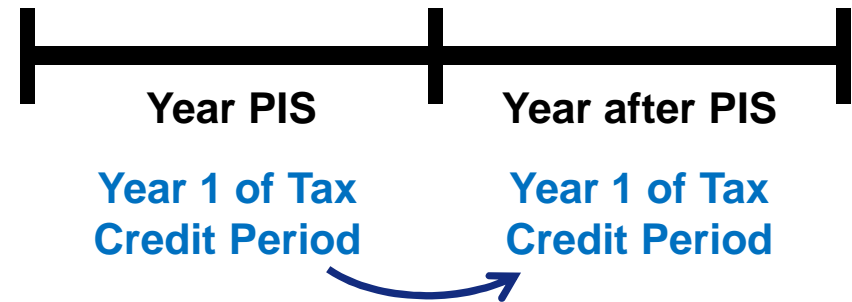
7

8a Original qualified basis of the building at close of first year of credit period

8a

b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No

9a If box 8a or box 8d is checked, do you elect to reduce eligible basis under section 42(N)(2)(iv)? Yes No



10 Check the appropriate box for each election:

Caution: Once made, the following elections are irrevocable.

- a** Elect to begin credit period the first year after the building is placed in service (section 42(f)(1)) ▶ Yes No

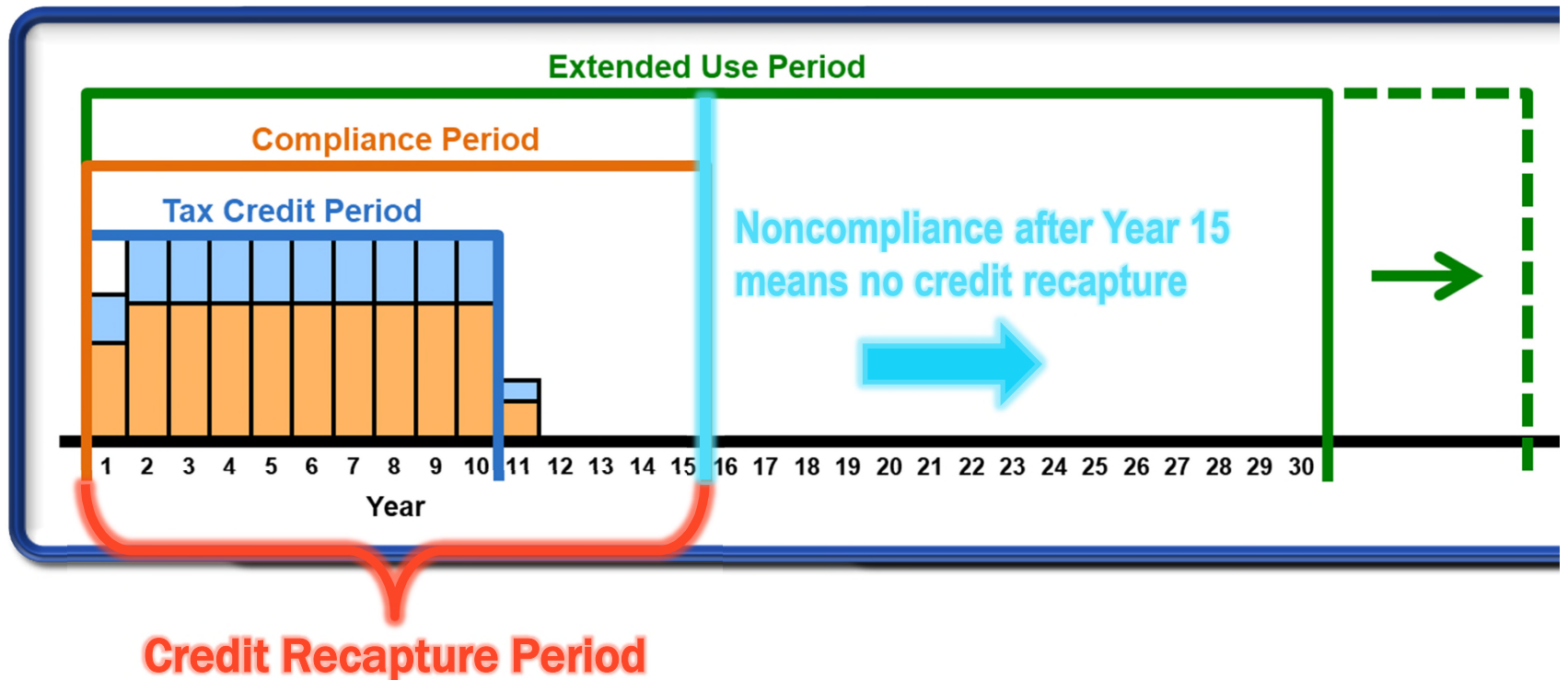
Under penalties of perjury, I declare that I have examined this form and accompanying attachments, and to the best of my knowledge and belief, they are true, correct, and complete.

Signature Taxpayer identification number Date

Name (please type or print) First year of the credit period

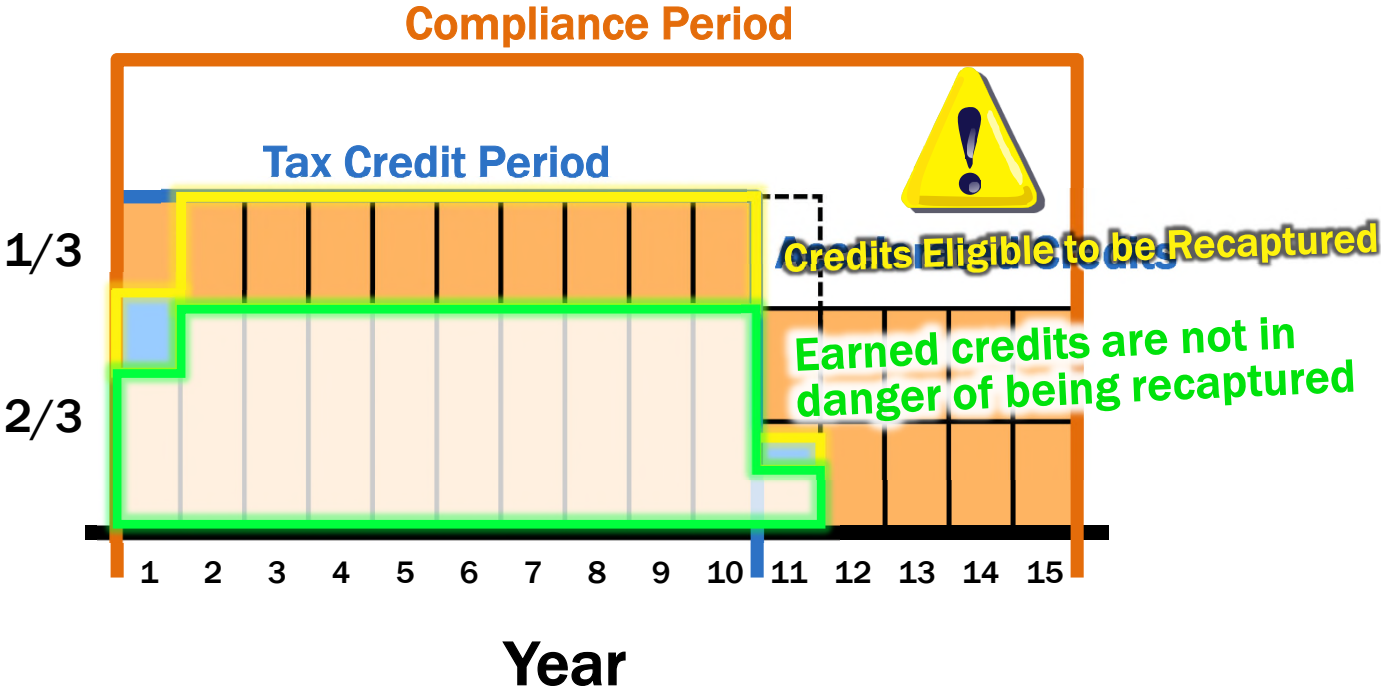
For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 63981U Form 8609 (Rev. 10-2014)

Extended Use Period

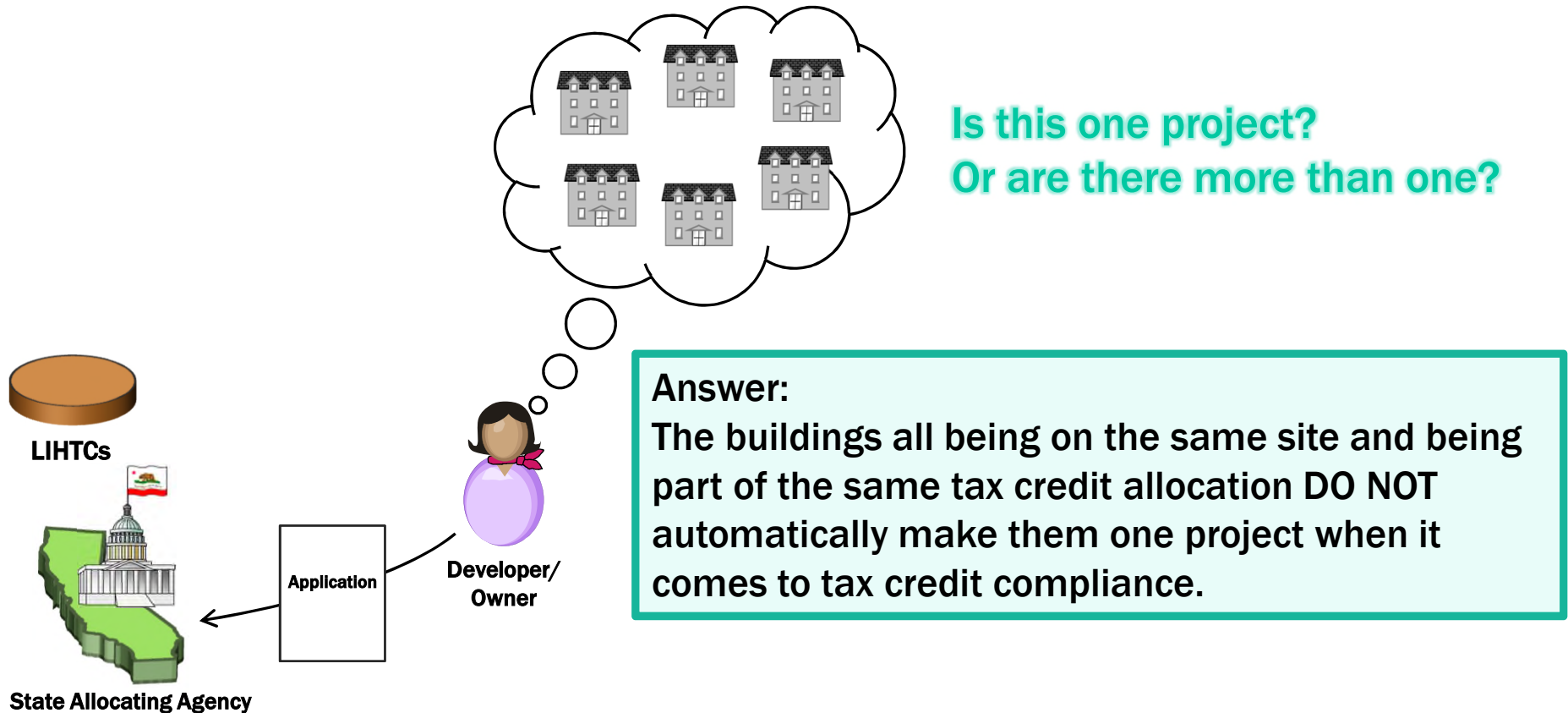


Compliance Period vs Tax Credit Period

For each building...



Definition of a Project



IRC §42(g)(3)(D) Projects with more than 1 building must be identified

“...a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide.”

Definition of a Project

How are the “projects” within a property identified?

Form 8609 Low-Income Housing Credit Allocation and Certification

Part I Allocation of Credit

Check if: Addition to Qualified Basis Amended Form

8b. Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No

10. Check the appropriate box for each election:

a. Elect to begin credit period the first year after the building is placed in service (section 42(f)(1)) Yes No

b. Elect not to treat large partnership as taxpayer (section 42(g)(5)) Yes No

c. Elect minimum set-aside requirement (section 42(g)(2)) (see instructions) 20-50 40-50 25-50 (N.Y.C. only)

d. Elect deep rent allowed project (section 142(d)(4)(B)) (see instructions) 15-40

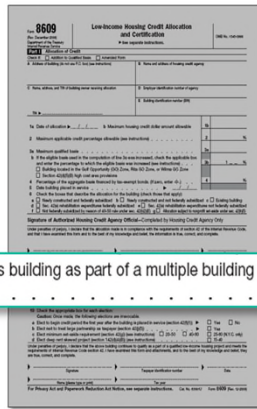
Step 1: Check ‘yes’ on Line 8b of a building’s Form 8609

Form 8609, Line 8b

IRC §42(g)(3)(D) Projects with more than 1 building must be identified

“...a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project **is identified in such form and manner as the Secretary may provide.**”

Definition of a Project

A screenshot of the Form 8609, Line 8b. The form is titled "Low-income Housing Credit Allocation and Certification" and includes various sections for project information. A red box highlights the question: "b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)?" with "Yes" checked and "No" unchecked.

Form 8609, Line 8b

Step 1: Check 'yes' on Line 8b of a building's Form 8609

Step 2: Attach a statement described in the 8609 Instructions

The statement must be attached to this Form 8609 and include:

- The name and address of the project and each building in the project,
- The BIN of each building in the project,
- The aggregate credit dollar amount for the project, and
- The credit allocated to each building in the project.



Notwithstanding a checked "Yes" box on line 8b, failure to attach a statement providing the above required information will result in each building being considered a separate project under section 42(g)(3)(D).

IRC §42(g)(3)(D) Projects with more than 1 building must be identified

"...a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii)), each building which is (or will be) part of such project **is identified in such form and manner as the Secretary may provide.**"

Minimum Set-Aside

Set aside at least **20% of units*** in a project to be rent restricted for households with incomes at or below **50% of area median income**

OR

Set aside at least **40% of units*** in a project to be rent restricted for households with incomes at or below **60% of area median income**

OR (as of 3/23/18)

Utilize the average income test (see next slide)

8609 Low-Income Housing Credit Allocation and Certification
 Form 8609 (Rev. May 2018)
 Department of the Treasury Internal Revenue Service
 OMB No. 1545-0082
 Go to www.irs.gov/Form8609 for instructions and the latest information.

Part I Allocation of Credit
 Check if: Addition to Qualified Basis Amended Form
 A. Address of building (do not use P.O. box) (see instructions) B. Name and address of housing credit agency
 C. Name, address, and TIN of building owner receiving allocation D. Employer identification number of agency
 E. Building identification number (BIN)
 TIN

1a Date of allocation b Maximum housing credit dollar amount allowable
 2 Maximum applicable credit percentage allowable (see instructions) 2 %
 3a Maximum qualified basis 3a
 b Check here if the eligible basis used in the computation of line 3a was increased under the high-cost area provisions of section 42(d)(5)(B). Enter the percentage to which the eligible basis was increased (see instructions) 3b 1 %
 4 Percentage of the aggregate basis financed by tax-exempt bonds. (If zero, enter -0-) 4 %
 5 Date building placed in service
 6 Check the boxes that describe the allocation for the building (check those that apply):
 a Newly constructed and federally subsidized b Newly constructed and not federally subsidized c Existing building
 d Sec. 42(e) rehabilitation expenditures federally subsidized e Sec. 42(e) rehabilitation expenditures not federally subsidized
 f Allocation subject to nonprofit set-aside under sec. 42(h)(5)
 Signature of Authorized Housing Credit Agency Official—Completed by Housing Credit Agency Only
 Under penalties of perjury, I declare that the allocation made is in compliance with the requirements of section 42 of the Internal Revenue Code, and that I have examined this form and to the best of my knowledge and belief, the information is true, correct, and complete.
 Signature of authorized official Name (please type or print) Date
Part II First-Year Certification—Completed by Building Owners with respect to the First Year of the Credit Period
 7 Eligible basis of building (see instructions) 7
 8a Original qualified basis of the building at close of first year of credit period 8a
 b Are you treating this building as part of a multiple building project for purposes of section 42 (see instructions)? Yes No
 8b If box 8a or box 8d is checked, do you elect to reduce eligible basis under section 42(f)(2)(B)? Yes No
 b For market-rate units above the average quality standards of low-income units in the building, do you elect to reduce eligible basis by disproportionate costs of non-low-income units under section 42(f)(5)? Yes No
 10 Check the appropriate box for each election.
 c **Elect minimum set-aside requirement (section 42(g)) (see instructions):**
 20-50 40-60 Average income 25-60 (N.Y.C. only)
 Signature Taxpayer identification number Date
 Name (please type or print) First year of the credit period
 For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 02951U Form 8609 (Rev. 05-2018)

Form 8609, Line 10c

IRC § 42(g)(1)

*** NOTE:**

Unlike a **building's** applicable fraction, which takes into account unit floor space, meeting a **project's** minimum set-aside takes into account the number of units only.

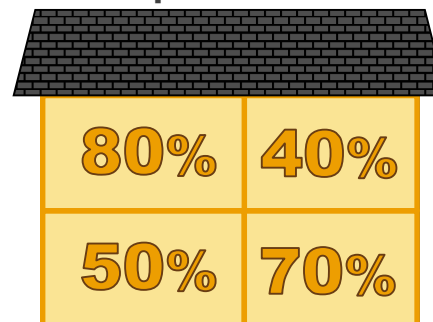
Average Income Test

March 23, 2018 – The Consolidated Appropriations Act of 2018 added a **new, third minimum set-aside option** beyond the 20-at-50 and the 40-at-60 set-aside. The third option creates an **Average Income** test as follows:

- At least 40 percent of a project’s units have to be both rent-restricted and occupied by individuals whose incomes do not exceed the imputed income limitation designated by the taxpayer
- The average of the imputed income limitations designated **cannot exceed 60 percent of AMI**
- The designated imputed income limitations must be in 10 percent increments as follows:

- 20 percent
- 30 percent
- 40 percent
- 50 percent
- 60 percent
- 70 percent
- 80 percent

Example:



$$\text{AVG} = 60\%$$

What's the *penalty* for a building that is within a project that is not meeting its minimum set-aside?

*Building's
Year 2-15:*

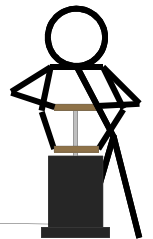
1. **100% recapture** of building's accelerated credits already claimed
2. **100% disallowance** of credits building would expect to claim for current year
3. **No new credits** in future years for the building until the minimum set-aside is met again

Building's

Year 1:

1. Building **cannot claim any** credits...ever!

CREDITS



Minimum Set-Aside vs Applicable Fraction

How many credits?

①

Any credits at all?

Individual buildings

②

Building –OR– Project

Lesser of “unit fraction”
and “floor space fraction”

③

Unit % only

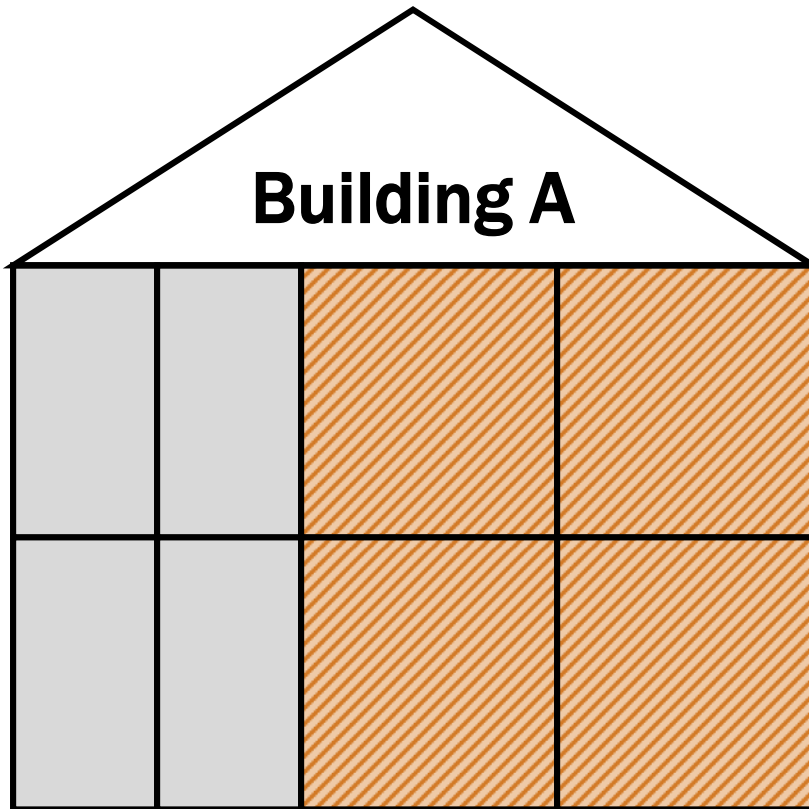
Calculating Credits

| | | |
|--------------------------------|-----------------|----------------|
| Eligible Basis | \$ 1,000,000 | ⁽¹⁾ |
| <u>x Applicable Fraction</u> | <u>x 1.0000</u> | ⁽²⁾ |
| Qualified Basis | \$ 1,000,000 | |
| <u>x Tax Credit Percentage</u> | <u>x 9 %</u> | ⁽³⁾ |
| Annual LIHTCs | \$ 90,000 | |
| <u>x Ten Years</u> | <u>x 10</u> | |
| Total LIHTCs | \$ 900,000 | |

- ⁽¹⁾ Each building within a property has its own tax credit calculation; **eligible basis** is essentially the residential building, the furniture and fixtures within it and its share of the property's landscaping, parking lot, sidewalks, etc.
- ⁽²⁾ A building's **applicable fraction** represents its portion of the residential units that are low-income qualified (lesser of unit fraction and floor-space fraction); the fraction is rounded to four decimal places
- ⁽³⁾ Treasury publishes a tax credit percentage each month; the tax credit percentage for a particular building will be for the month the building is placed in service; alternatively, it could be locked by the building owner shortly after the announcement of the tax credit award; if the building is financed in part with private activity tax-exempt bonds, the tax credit percentage will be around 3.25% to 3.5% if it's older than 2021; if it's newer than 2020, it will be **4%**; if it's not financed with bonds, and it's older than 2008, the percentage will be around 7.5% to 8.5%; if it's not financed with bonds and it's 2008 or newer, the percentage will be **9%**.

Applicable Fraction

(lesser of unit fraction and floor space fraction)



-  Low-income units
-  Market-rate units

Applicable Fraction

Unit Fraction:

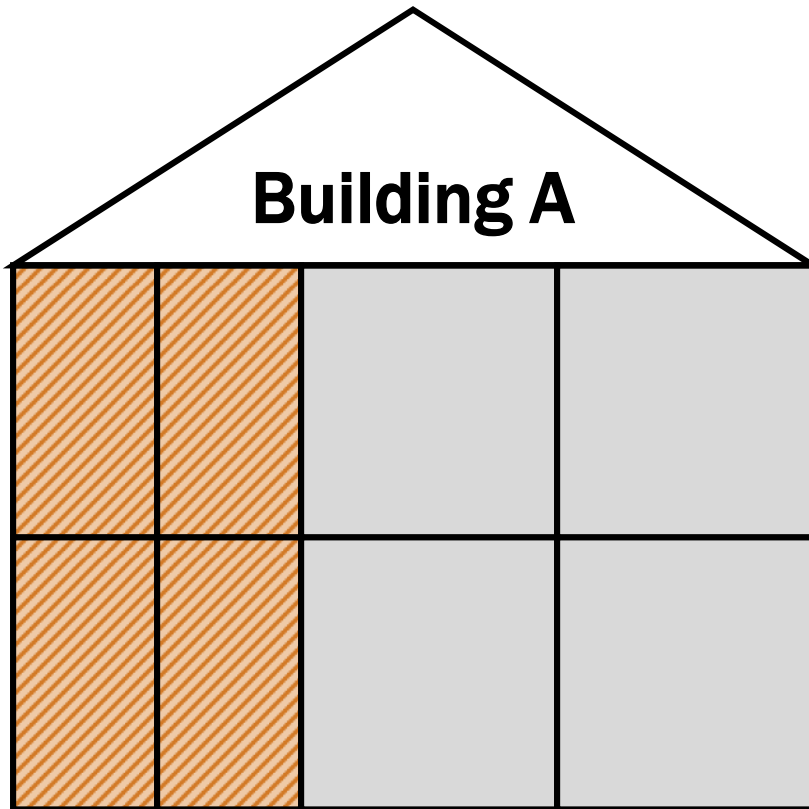
50%

Floor Space Fraction:

65%

Applicable Fraction

(lesser of unit fraction and floor space fraction)



-  Low-income units
-  Market-rate units

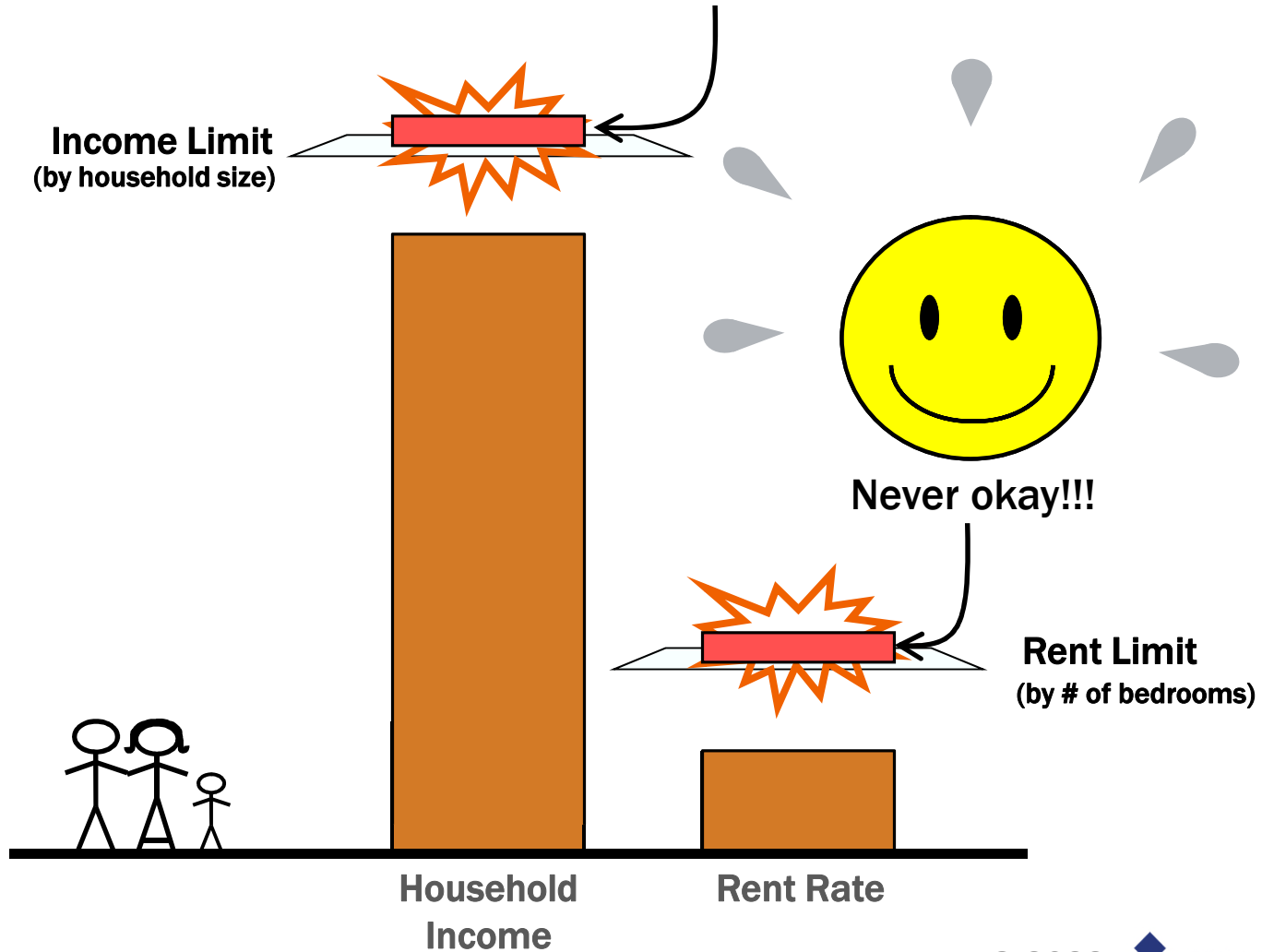
Applicable Fraction

Unit Fraction: 50%

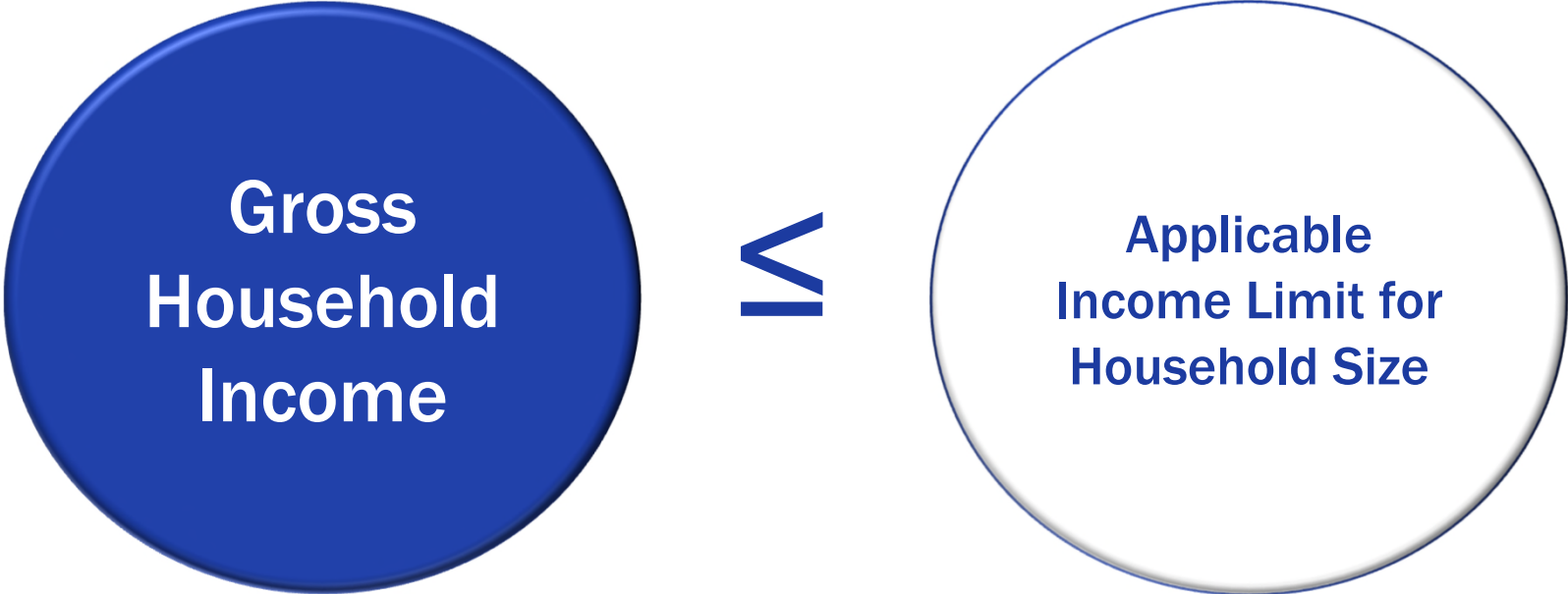
Floor Space Fraction: 35%

Tenant Certification

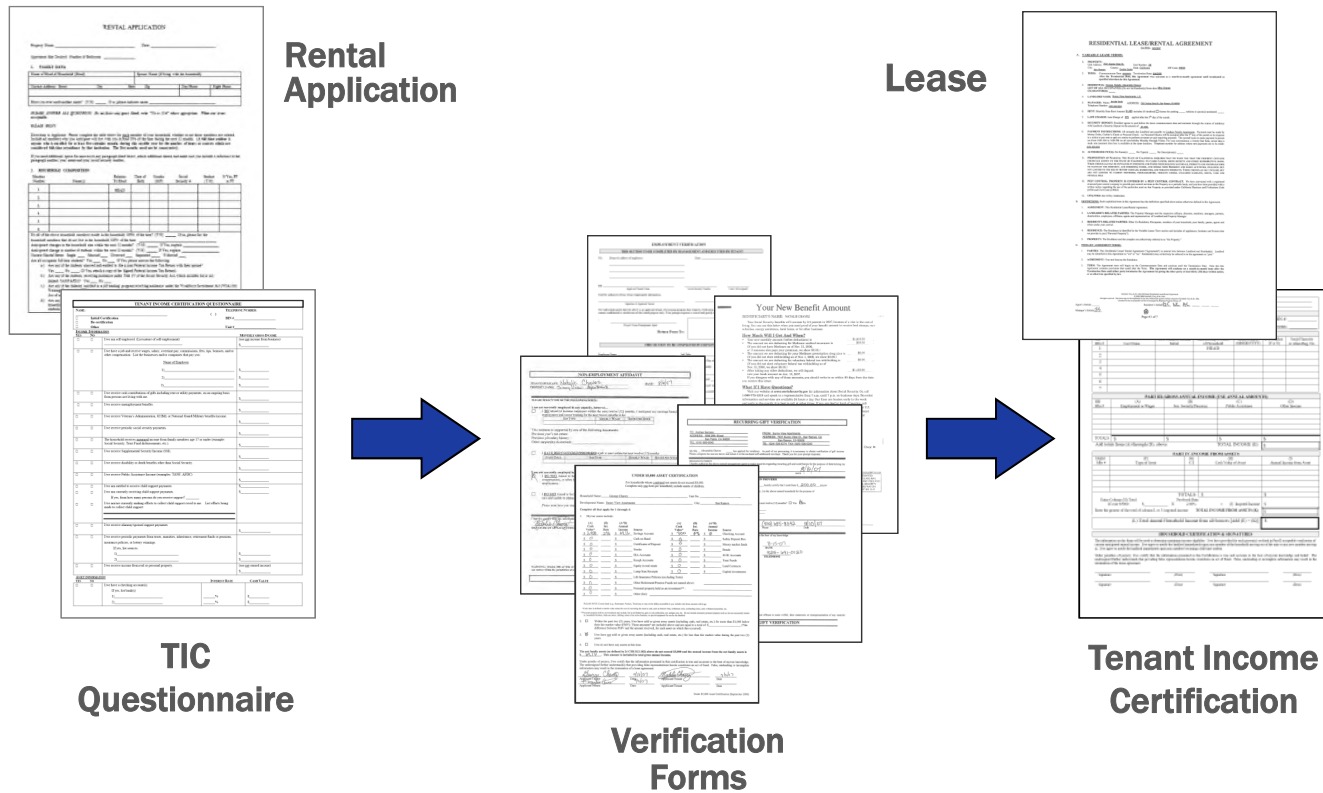
Violation at initial income certification;
Okay at annual recertification ... watch for the Available Unit Rule!



Tenant Certification



Tenant Certification Process



What is Income?

5-4 Key Requirements

- A. Annual income is the amount of income that is used to determine a family's eligibility for assistance. Annual income is defined as follows:
1. All amounts, monetary or not, that go to or are received on behalf of the family head, spouse or co-head (even if the family member is temporarily absent), or any other family member; or
 2. All amounts anticipated to be received from a source outside the family during the 12-month period following admission or annual recertification effective date.
- B. Annual income includes all amounts that are not specifically excluded by regulation. Exhibit 5-1, Income Inclusions and Exclusions, provides the complete list of income inclusions and exclusions published in the regulations and *Federal Register* notices.
- C. Annual income includes amounts derived (during the 12-month period) from assets to which any member of the family has access.

HUD Handbook 4350.3, Chapter 5 Section 1: Determining Annual Income

Who is a Household Member?

Includes:

All persons living in the unit 50% or more of the time (including foster children and adults) plus:

- a. Children temporarily absent (in foster home)
- b. Children in joint-custody (present 50% or more)
- c. Children away at school (return during recesses)
- d. Unborn children of pregnant women
- e. Children in process of being adopted
- f. Temporarily absent family members who are still considered family members
- g. Family members in hospital or rehab for limited or fixed periods
- h. Persons permanently confined to hospital or nursing home*

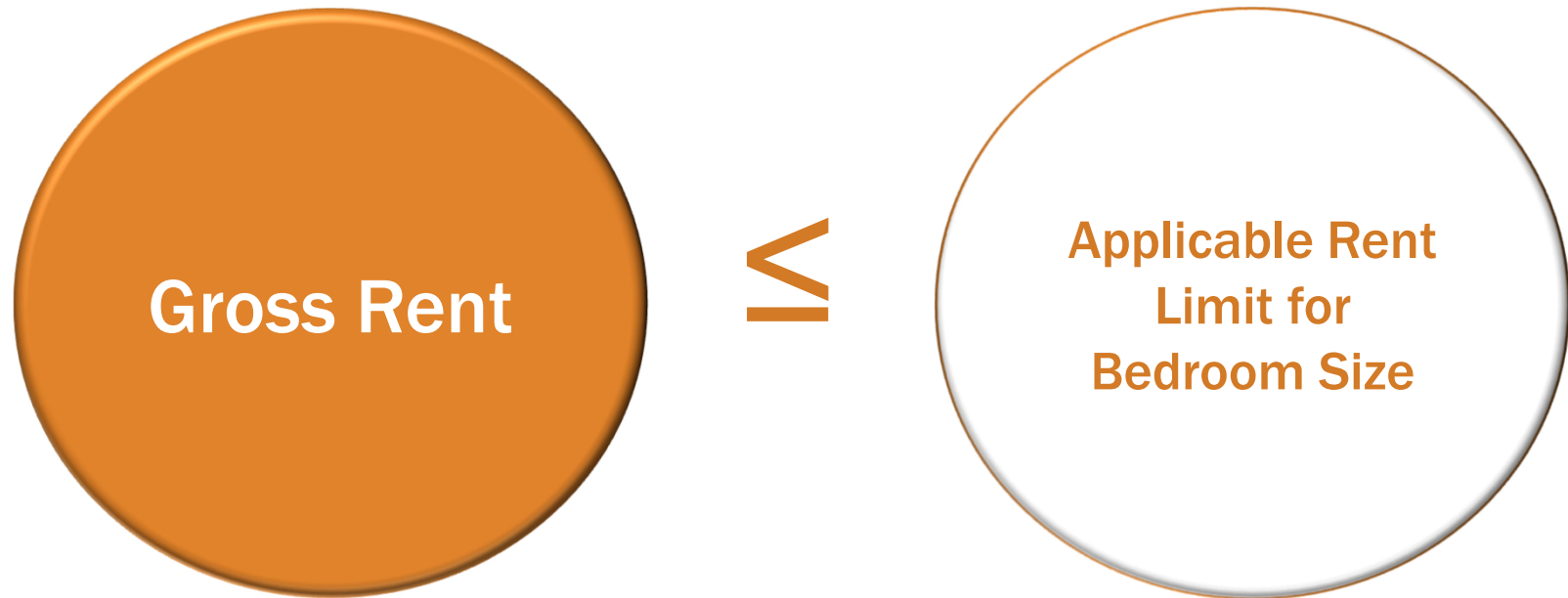
Excludes:

- a. Live-in aides
- b. Guests

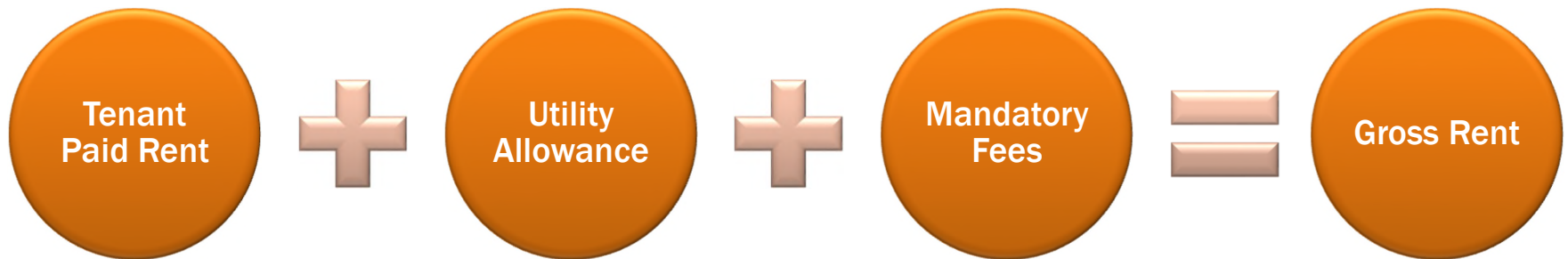
* Family chooses, but has to include income if they count the person in household

HUD Handbook Chapter 3: Paragraphs 3-6.E.3&4

Rent



Calculating Gross Rent



What if the household receives section 8 rental assistance?

DO NOT INCLUDE!

Utility Allowances

§ 1.42-10 Utility allowances.

(a) Inclusion of utility allowances in gross rent. If the cost of any utility (other than telephone, cable television, or Internet) for a residential rental unit is paid directly by the tenant(s), and not by or through the owner of the building, the gross rent for that unit includes the applicable utility allowance determined under this section. This section only applies for purposes of determining gross rent under section 42(g)(2)(B)(ii) as to rent-restricted units.

| IF: | Then the appropriate utility allowance is: |
|---|--|
| Buildings assisted by Rural Housing Service (RHS) | 1. RHS Utility Allowance |
| Buildings with RHS assisted tenants | |
| Buildings regulated by HUD | 2. Applicable HUD Utility Allowance |
| All other buildings* | 3. PHA Utility Allowance 4. Local Utility Company Estimate 5. State Agency Estimate 6. HUD Utility Schedule Model 7. Energy Consumption Model (performed by engineer or other professional approved by state agency) |

* Individual units with tenants receiving HUD rental assistance must use the applicable PHA Utility Allowance (No. 3 in our list)

Fees

Treas. Reg. § 1.42-11

(a) **General rule.** The furnishing to tenants of services other than housing (whether or not the services are significant) does not prevent the units occupied by the tenants from qualifying as residential rental property eligible for credit under section 42. However, **any charges to low-income tenants for services that are not optional generally must be included in gross rent** for purposes of section 42(g).

(b) Services that are optional.

(1) *General rule.* **A service is optional if payment for the service is not required as a condition of occupancy.** For example, for a qualified low-income building with a common dining facility, the cost of meals is not included in gross rent for purposes of section 42(g)(2)(A) if payment for the meals in the facility is **not required as a condition of occupancy** and **a practical alternative exists** for tenants to obtain meals other than from the dining facility.

Students



Treas. Reg. §1.151-3(b)

Full-time students are “enrolled for some part of 5 calendar months for the number of hours or courses which is considered to be full-time attendance. **The 5 calendar months need not be consecutive.** School attendance exclusively at night does not constitute full-time attendance.”

Treas. Reg. §1.151-3(c)

A qualifying educational institution is “a school maintaining a regular faculty and established curriculum, and having an organized body of students in attendance. It includes primary and secondary schools, colleges, universities, normal schools, technical schools, mechanical schools, and similar institutions, but **does not include noneducational institutions, on-the-job training, correspondence, night schools, and so forth.**”

Students



Generally, a household WON'T qualify for an LIHTC unit if the household is comprised entirely of full-time students.

- **EXCEPTIONS (household of full-time students qualifies if):**

One tenant:

- Receives Title IV of Social Security Act (TANF)
- Is enrolled in Job Training Partnership Act program or similar program
- Was previously a foster child (effective after 7/31/08)

All tenants are:

- Single parents and their dependent children (but parent and children can't be dependents of another individual), OR...
- Tenants married and file joint tax return (or able to file a joint tax return)

Lease Considerations

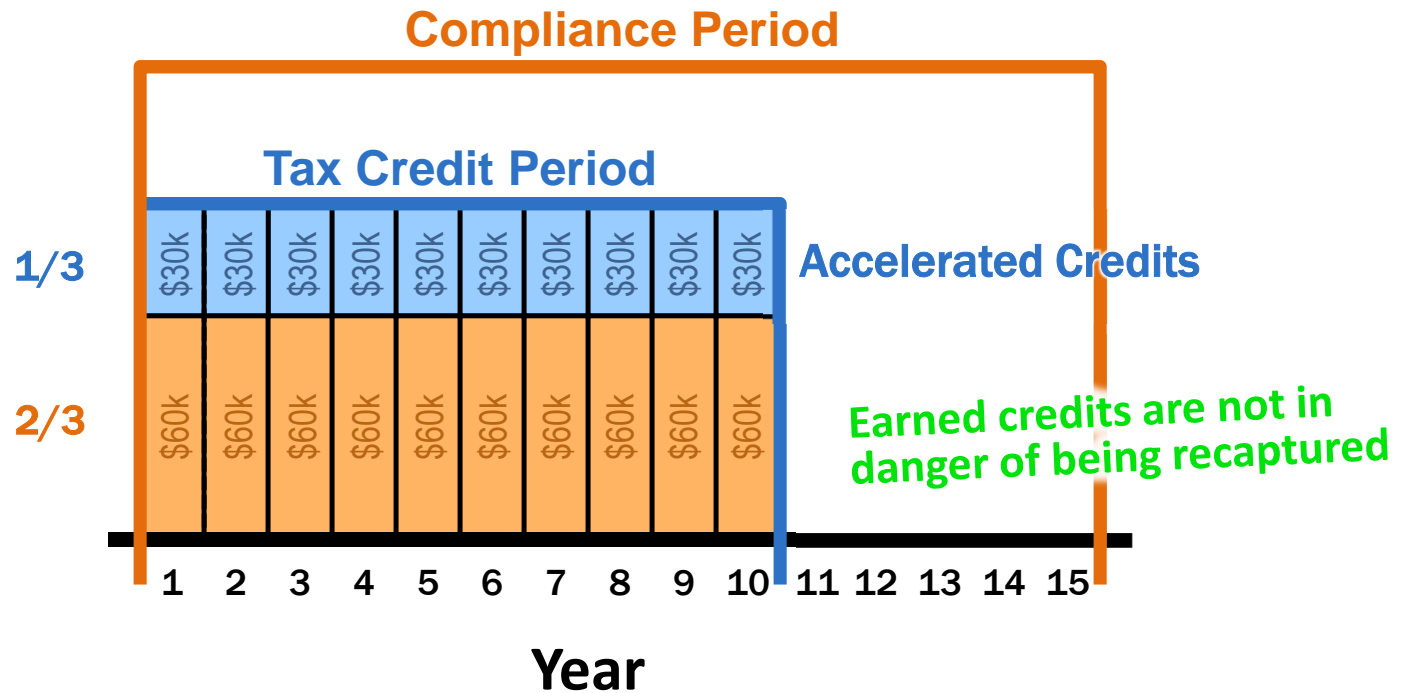
OCCUPANCY REQUIREMENTS IRC §42(i)(3)

- Suitable for occupancy
- Non-transient use (**initial lease ≥ 6 months**) for non-SRO units
- Cannot be entirely occupied by full-time students (unless an exception is met)
- For use by general public consistent with:
 - Fair Housing Act
 - **IRC §42(g)(9)** – A project does not fail to meet the general public use requirement solely because of occupancy restrictions or preferences that favor tenants:
 - With special needs
 - Who are members of a specified group under a federal or state program
 - Are involved in artistic or literary activities
 - HUD non-discrimination rules

Calculating Credits

| | |
|--------------------------------|------------------|
| Eligible Basis | \$ 1,000,000 |
| <u>x Applicable Fraction</u> | <u>x 1.0000</u> |
| Qualified Basis | \$ 1,000,000 |
| <u>x Tax Credit Percentage</u> | <u>x 9 %</u> |
| Annual LIHTCs | \$ 90,000 |
| <u>x Ten Years</u> | <u>x 10</u> |
| Total LIHTCs | \$ 900,000 |

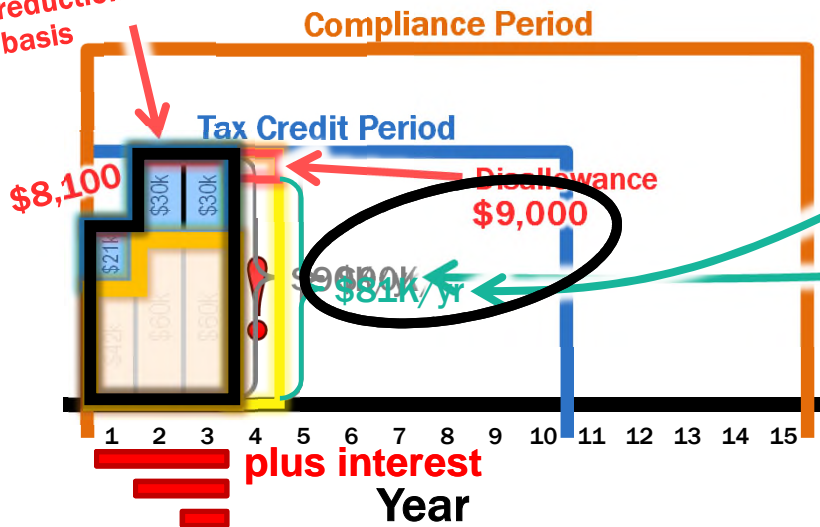
Credit Delivery



Calculating Credit Loss

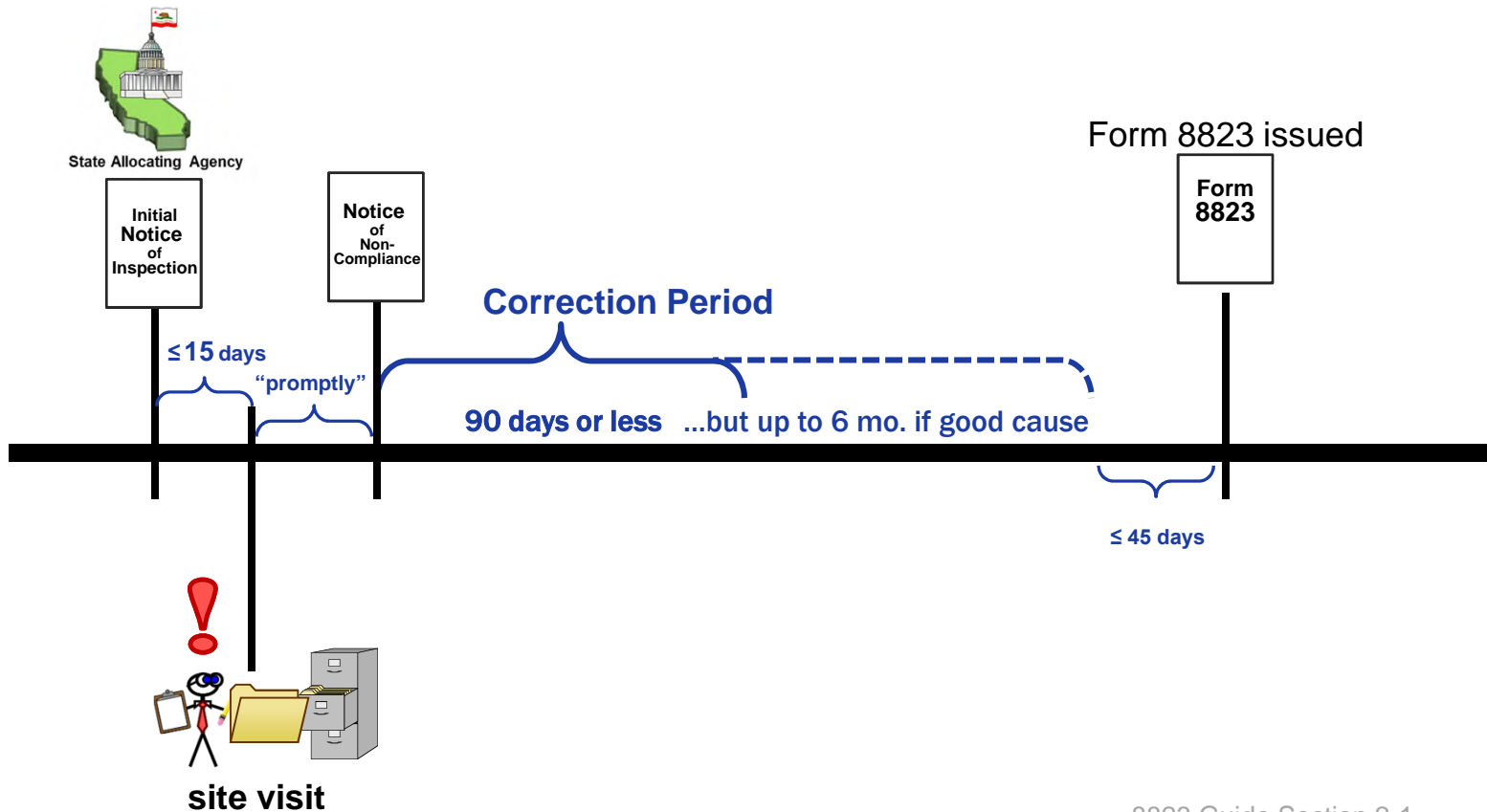
For each building...

Recapture Risk: Unearned credits proportionate to reduction in qualified basis



| | |
|------------------------------|---------------------|
| Eligible Basis | \$ 1,000,000 |
| Applicable Fraction | x 1.0000 |
| - 10% Qualified Basis | \$ 900,000 ↓ |
| Tax Credit % | x 9% |
| Annual LIHTCs | \$ 81,000 |
| QB reduction | x 10% |
| Disallowance | \$ 8,100 |
| Credits claimed | \$ 243,000 |
| Credits earned | - 162,000 |
| Credits unearned | \$ 81,000 |
| QB reduction | x 10% |
| Recapture | \$ 8,100 |

Inspection Timeline



8823 Guide Section 2-1

“Bright Line” Date

occupancy based on local health, safety, and building codes or whether the buildings and units satisfy the uniform physical condition standards established by HUD.²

Noncompliance issues identified and corrected by the owner prior to notification of an upcoming compliance review or inspection by the state agency need not be reported; i.e., the owner is in compliance at the time of the state agency’s inspection and/or tenant file review. Small Business/Self-Employed (SB/SE) considers the date of the notification letter a “bright line” date comparable to the rules for requesting a PLR or the disclosure on Form 1040X that an amended tax return is being filed after being audited by the IRS or subsequent to notification that it will be audited. See Form 1040X, line B.

a Sample The sample of files or units to be inspected must not give the owner advance notice of which units and tenant records are to be inspected and reviewed.³ There is no advantage to selecting different units over the 15-year compliance monitoring cycle.

If the sample includes a currently vacant unit, then the last (re)certification for the last tenant should be reviewed. The “snap shot” is indicative of current compliance.

Interpreting the Results The IRS uses the results of the state agencies’ reviews as an indicator of the owner’s level of compliance with IRC §42 requirements. If needed, the IRS can also use the results to make adjustments to the LIHC on a unit-by-unit basis as identified on Form 8823. However, the IRS cannot project the results to the entire population of LIHC units.⁴

¹ See Treas. Reg. 31.42-5(c)(2).
² Treas. Reg. 31.42-5(c)(3)(i) refers to an “annual income certification” which for clarity purposes is often referred to as a “recertification.”
³ See Treas. Reg. 31.42-5(c)(2)(i)(A) and (B).
⁴ Treas. Reg. 31.42-5(c)(2)(ii).
⁵ The IRS has specific requirements for using sampling techniques as part of an income tax audit. A state agency is not required to use these more stringent techniques for random selection and sample size when conducting a compliance review.

i.e. no Form 8823 required

8823 Guide
p. 3-2

Record Retention

- **Revenue Ruling 2004-82**
 - Electronic storage is acceptable for tenant files for IRS purposes
 - State agencies may still require paper copies
- **Treasury Regulation §1.42-5**
 - Number of residential units and sq ft of each unit
 - Percentage of low-income units
 - Rents charged and utility allowance documentation
 - Number of occupants in each unit
 - Vacancies and dates of move-in/out
 - Income certification and documentation
 - Eligible basis and qualified basis at close of first credit period
 - Character and use of common area
 - Records should be retained for **6 years**
 - Records of the tenants that initially qualified the units back in Year One should be retained for **21 years**